



Katerina Joannou
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Dear Ms. Joannou,

Consultation paper on prospective financial information (“PFI”)

We are writing to you in response to your request for comments on your consultation paper on PFI (the “Consultation Paper”).

We understand and support the overall objective in your proposals to update the guidance for the preparers of PFI (the “Guidance”). We agree that a ‘principles plus guidance and application notes’ approach remains wholly appropriate to underpin the guidance provided for UK Directors in relation to PFI. We would note that we are not aware of systemic failures in the preparation of PFI since the publication of the Guidance that would indicate that a wholesale revision of the methodology is justified or required.

The Consultation Paper seeks to ensure that all types of PFI are both covered by the Guidance and subject to the same principles, an approach we support. The application notes referred to in the Consultation Paper will, however, be of fundamental importance in ensuring that an appropriate, tailored approach is undertaken by Directors dependent upon the circumstances for which the PFI is being used or has been prepared.

We believe that any updated principles, guidance and application notes would benefit from explicit recognition that companies report PFI in differing forms and for varying purposes. The consequences of this are, amongst other things, differences in the extent of historical information as a benchmark for preparation of PFI, in the sophistication of underlying financial reporting systems and in the relative level of confidence applied in future forecasting. As such, the introduction of the “aligned” attribute appears potentially problematic to us unless it is very narrowly defined.

Given the proposals set out in the Consultation Paper, the Guidance will need to contain a far more extensive definition of different forms of PFI. This definition will need to be carefully worded to ensure it would not become outdated in light of new market developments, to the extent practicable. We also see certain practical implications of extending the scope of the Guidance and have detailed these in our responses to the specific questions set out in the Consultation Paper in Appendix 1.

We support the suggestion that the Guidance could be extended to corporate and financial reporting beyond capital market transactions and fundraising, provided that it is appropriately adapted. We therefore agree that a working group with the relevant expertise should address this.

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We would very much welcome the opportunity to be part of the debate in working with you to develop these proposals. If you would like to discuss any of the specific points we have raised please do feel free to contact Mark Hughes (mark.c.hughes@pwc.com) or Kevin Desmond (kevin.desmond@pwc.com)

Yours sincerely,

PricewaterhouseCoopers LLP.

PricewaterhouseCoopers LLP



Appendix 1

Responses to specific questions

Q1: In your view what are the most important recent and prospective developments that ICAEW will need to take into account when updating the 2003 guidance?

As set out in the Consultation Paper, we acknowledge that there have been a large number of developments that affect the preparation of businesses PFI, some of which will be more relevant to more established and sophisticated companies. We would note the following:

- an increasing desire amongst EU regulators, especially since the Prospectus Directive, to ensure as much consistency as possible in practice across member state markets;
- an increase in the number of “early stage” companies coming to the public markets without the history of market reporting and sophistication of reporting systems of mature, existing listed businesses;
- an increasing prevalence of the provision by Directors of market guidance, such as synergy benefits and quantified financial benefits statements; and
- as a result of increasing international M&A activity, an increasing prevalence of overseas companies having to reassess previously published PFI in light of UK regulatory requirements.

Q2: ICAEW has received feedback from preparers, regulators, advisers and users of PFI on the application of the 2003 guidance. Do you have any comments on the feedback summarised in this section and any additional observations?

We agree that it is not common practice in the UK to provide ‘voluntary’ PFI externally. The Consultation Paper notes the absence of safe harbours, in addition, we believe that the absence of companies publishing voluntary PFI is due to the fact that in the UK market, the consequences of a company not achieving against its published PFI can be significant, as the market participants do not view published PFI as a target or an aspiration in the way that it may be viewed in other countries.

As discussed in our covering note we agree that the focus on a principles and application guidance remains a wholly appropriate methodology to underpin the guidance provided for UK Directors in relation to PFI.

In our experience, we note that the Guidance is used and applied in those situations caught within its scope, in particular where PFI is being published in connection with a UK Capital Markets transaction. In these circumstances we agree with the construct outlined in the Guidance, that any published PFI should have “very little risk” associated with it in terms of being achievable. For example, a working capital statement made by the Directors and to be included within an Investment Circular should only be made if there is “very little risk” that the company and its group will have insufficient working capital for the period of 12 months after the Investment Circular. The concept of “very little risk” provides important protection for investors who will be using the Investment Circular, and the PFI statements included therein, to form investment decisions. In these instances, it should be noted that the users of this PFI often do not have the ability to readily access management or any detailed forecasts or projections that underpin the PFI statements included in the Investment Circular.

The concept that published PFI should have “very little risk” associated with it works well in the context of UK Capital Markets transactions. We believe that the “very little risk” concept would be less suitable, in its current form, for many of the other PFI situations that the Consultation Paper suggests could be brought within scope. For example, listed companies are required to make a viability



statement within their Annual Report; however the basis on which this statement is made must reflect a reasonable expectation of business performance. This statement is also subject to safe harbour protections for Directors under s463 of the Companies Act 2006 (as long as the viability statement is within the Directors' Report or the strategic report). This contrasts with the “very little risk” model, reflecting the different purposes of the two types of reporting.

Similarly when a company is preparing a business plan in order to source additional private financing, the business plan will often be based on business aspirations or expectations rather than a prudent scenario applied in a working capital reasonable downside case as prescribed by the ESMA Prospectus Directive recommendations. It is worth noting that in these circumstances, the users of the published PFI (for example a bank or private equity investor) will have access to both management and the underlying PFI forecasts and projections and is therefore able to perform additional independent diligence in order to assist in making an informed decision as to whether the PFI is appropriately prudent for their use.

Q3: The proposed new framework for PFI will comprise:

- ***general principles for the preparation of PFI; and***
- ***guidance notes on applying the principles and application notes covering specific types of PFI, in certain circumstances.***

Do you have any comments on whether this is an appropriate structure?

We agree with the proposed approach that the principles outlined in the Guidance are supplemented by application notes that are specific to different scenarios for which PFI may be published. This will enable the Institute of Chartered Accountants England and Wales (the “Institute”) to identify instances where deviations in application is appropriate e.g. not adhering to the “very little risk” concept in private financing scenarios or when making statements which are governed by other regulatory bodies e.g. the viability statement required in a UK listed company Annual Report. As noted in our covering letter we believe that each application note should clearly define the perimeter of situations to which it applies (e.g. viability statement, impairment testing).

We believe that the Institute should initially focus on publishing the updated principles, guidance and application notes for the more common areas of published PFI and then look to introduce new application notes as the need arises. We also believe that, whilst it is appropriate to remove the specific regulatory rule references from the Guidance, it would be appropriate to include these rule references in the application notes. This provides the additional benefit that the Institute would be able to update each application note individually in response to any rule reference changes without having to reissue the complete PFI guidance. This also allows the application notes to specifically address the relevant rules and regulatory requirements.

We note that the Guidance refers only to members of the Institute. Consequently we believe that it will be important for the Institute to promote the use of any new Guidance, possibly through the use of technical notes, is supported by various parties connected with PFI e.g. the FCA, the FRC and the LSE. This would ensure that the guidance extends to those Directors who are not currently members of the UK Institute.

Q4: ICAEW intends to keep the four attributes of useful PFI and the three principles for preparing PFI that are set out in the 2003 guidance, while adding two new attributes. Do you believe that the existing attributes and principles continue to be appropriate and necessary? Do you have any comments on the proposed additional attributes of



useful PFI that it should be aligned and 'not misleading'? Do you believe that new preparation principles are needed for the additional attributes?

The “not misleading” attribute appears uncontroversial and appropriate to improve consistency as noted in the Consultation Paper. We believe that “not misleading” should include reference to adjusted measures and their prominence within PFI. Adjusted measures should not be the focus of any PFI, with GAAP measures being the “headline” figures.

We would note that the UK Corporate Governance Code includes a provision (C.1.1) under which the boards of companies that apply the Code are expected to consider whether “price-sensitive public reports and reports to regulators as well as ... information required to be presented by statutory requirements” presents a fair, balanced and understandable assessment of the company’s position and performance, business model and strategy”. This would support the “not misleading” attribute for these companies.

As noted in our covering letter, the introduction of the “aligned” attribute appears potentially problematic to us unless it is very narrowly defined. The display of integrated and cohesive management thinking by business reporting and communications appears a challenge for all but the most sophisticated companies. Most PFI exercises are specific for a purpose and are not a simple product of an integrated reporting system.

The Directors should, of course, ensure that the expectations underlying the PFI do not contradict their core business strategy. However, it is wholly typical for many forms of PFI to have significant adjustments made, whether in relation to overall strategy or specific actions, in order to address the key concern of Directors to be suitably prudent in issuing the PFI. An example would be the “very little risk” requirement underlying a working capital statement where typically the Directors would apply contingencies and variations to their Business Plan.

The Consultation Paper itself refers to “most established businesses” which raises the question how the aligned attribute would apply to the other established businesses or those which are not established.

Q5: ICAEW proposes extending the scope of the framework to PFI that is prepared for private finance-raising situations. Do you have any comments on applying the principles and attributes of useful PFI to private finance-raising and the forms of PFI and private finance raising involved.

We would support the extension of the scope of the framework to PFI that is prepared for private finance-raising situations. However, we consider it important that the Guidance distinguishes between the application of the general principles and the specific application of the Guidance in such situations. As set out in our response to question 2, we highlight that we feel there are important differences when comparing PFI prepared for this purpose with PFI prepared in connection with a capital markets transaction.

In addition, as we set out in our response to question 3, we believe it will be important for the Institute to have the guidance endorsed by the FCA, as in private reporting situations there is potentially not the same level of scrutiny from bodies such as reporting accountants and investment banks who understand the application of the Guidance.

Q6: ICAEW proposes developing new application notes for preparing PFI in the context of regulated, capital markets transactions. Such notes will address topics (eg, profit forecasts and estimates, changes in expectations of performance, working



capital statements, and synergy benefits and quantified financial benefits statements) but will not reproduce specific detailed regulations. Do you have any comments in relation to the topics identified and the nature of the application guidance?

We strongly support the development of new guidance and application notes to address the topics identified. We would note that there is currently a wide range in the formality (or indeed existence) of guidance for Directors and their advisers in relation to these topics.

The guidance notes referred to in the Consultation Paper will, however, be of fundamental importance in ensuring that an appropriate, tailored approach is undertaken by Directors dependent upon the circumstances.

The nature and circumstances of a Capital Markets exercise will also require careful consideration in the guidance notes. For example, a debt free investment entity undertaking a fund raising without any committed capital expenditure will (appropriately) carry out a different level of working capital analysis than an embattled listed trading company putting out a profit forecast in advance of its most important seasonal trading period.

Q7: ICAEW proposes to develop an application note for private finance-raising situations where proportionate application of the PFI framework is appropriate. What other form of application support might be useful for preparing PFI for private finance-raising? Do you have any comments as to how this might be developed in conjunction with specialist groups, and whether additional application notes should be developed for specific types of private finance-raising?

The Consultation Paper notes that the Working Group proposes to develop guidance on proportionate application, which we believe should take the form of a specific application note for private finance-raising scenarios. As noted in our response to question 6, we would support the development of an application note for such circumstances. We consider it to be important that when drafting the application note, the proportionate approach does not simply mean that Directors undertake less work than they could otherwise have done. We would recommend that the application note clearly defines the perimeter for PFI in private finance-raising scenarios.

Q8: ICAEW plans to explore whether the new framework could be extended to a wider range of PFI, such as PFI that underpins financial reporting and broader corporate reporting requirements and PFI prepared for purposes other than finance-raising. Do you have any comments on whether such extended application would be beneficial and what sorts of PFI might be covered?

As noted in our response to question 2, we believe that the Guidance could be extended to PFI that underpins financial reporting and broader corporate reporting requirements but that there are differences in the methodology employed by companies depending on both the maturity of the company and the information that they are preparing. The application notes on any additional areas of PFI will be of fundamental importance in ensuring that an appropriate, tailored approach is undertaken by Directors dependent upon the circumstances.

In relation to Capital Markets transactions, we believe that the Institute should initially focus on publishing the updated principles, guidance and application notes for the more common areas of published PFI and then look to introduce new application notes as the need arises. As noted in our covering letter, we think there is a specific need for guidance for directors on the preparation of forward-looking information in corporate and annual financial reporting.